The Scottish Taxes Policy Forum

Discussion Paper

Devolving Taxes across the UK: Learning from the Scottish Experience
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The Scottish Taxes Policy Forum

The Scottish Taxes Policy Forum (STPF) was formed in 2017 by the Institute of Chartered Accountants of Scotland (ICAS) and the Chartered Institute of Taxation (CIOT) to collaborate on technical analysis of Scottish tax matters. The group aims to produce and build alignment around expert opinions that are clear, realistic, accurate and politically neutral.

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Discussion Paper

Devolving Taxes across the UK:
Learning from the Scottish Experience

Twenty-one years after the people of Scotland voted in favour of a Scottish Parliament with tax raising powers, this paper considers the implementation of the devolved tax powers in Scotland and asks, from an operational perspective, how well ‘Scottish taxes’\(^1\) are working for Scotland and for the rest of the UK. The Scottish Taxes Policy Forum (STPF) makes a number of observations that should be considered by policy makers and asks some key questions that require further consideration.

The STPF proposes further strategic engagement with government, politicians and wider civic society, with the aim of promoting greater public awareness and understanding of Scotland’s changing tax landscape and its interaction with the wider UK tax regime.

Index

1. The Scottish Taxes Policy Forum (STPF)
2. Executive summary
3. Introduction
4. Scotland’s tax landscape
5. Partially devolved Income Tax
6. The interaction between Scottish Income Tax and UK Income Tax reliefs
7. Increasing scope for tax planning
8. Identification of Scottish, Welsh and other taxpayers
9. Interaction with National Insurance Contributions (NICs)
10. Cohesion across the UK – at what level?
11. Simplification – is it seeking the impossible?
12. Hypothecated taxes
13. Tax processes
14. The potential for new taxes
15. The Scottish Taxes Policy Forum’s recommendations
16. Looking forward

Appendix 1
Scottish taxes in brief

Appendix 2
Adam Smith’s four canons of taxation

Appendix 3
Glossary of terms

Appendix 4
List of questions in this paper

Appendix 5
Quick-read: executive summary and STPF recommendations

Appendix 6
The Scottish Taxes Policy Forum

\(^1\) See Section 4 and Appendix 1
1 The Scottish Taxes Policy Forum (STPF)

1.1 The Scottish Taxes Policy Forum (STPF) was formed in 2017 by the Institute of Chartered Accountants of Scotland (ICAS) and the Chartered Institute of Taxation (CIOT) to collaborate on technical analysis of Scottish tax matters. The group aims to produce and build alignment around expert opinions that are clear, realistic, accurate and politically neutral.

1.2 For this paper the STPF is grateful for the contributions of a number of interested parties, all of whom have an interest in promoting greater awareness and understanding of the tax regime applicable in Scotland.

2 Executive summary

2.1 Purpose: This paper aims to review and provide a critique of the current tax powers that have been devolved to the Scottish Parliament - their challenges, risks and opportunities - and to discuss the progress of devolution of taxes to Scotland since the 1998 Scotland Act. The aim is to initiate a debate amongst tax practitioners, academics and government with the eventual objective of this debate filtering through to the general public, to promote greater awareness and wider discussion. The main focus is on the taxes devolved in the Scotland Acts of 2012 and 2016 with a special emphasis on Scottish Income Tax (SIT), given its importance in terms of numbers of taxpayers affected and revenues raised. Appendix 1 to the paper provides a summary and description of the current Scottish taxes.

2.2 Underlying principle: Adam Smith’s four canons of taxation have been adopted by the Scottish Government in its approach to taxation, namely, certainty, convenience, efficiency and burden proportionate to the ability to pay (see Appendix 2). These are high level principles, but there are also other objectives such as the need to raise funds, bring accountability, support other policies such as economic growth, and redistribute resources.

2.3 Focus: This paper focuses on the operational aspects of Scottish taxes with the questions of principle that such operational matters flush out, such as:

- The interaction of SIT rates with UK mechanisms for giving tax relief at source (e.g. pensions relief, or Gift Aid) - which leads to the question of whether Income Tax reliefs should be delivered in a different way, devolved, or abolished altogether.

- The need for both SIT calculations for non-savings, non-dividend (NSND) income and UK based calculations if a Scottish taxpayer also has savings income and dividends introduces added complexity for taxpayers, agents and HM Revenue & Customs (HMRC) – which leads to the question of whether Income Tax rates and bands applicable to all sources of income should be devolved.

- The possibility of tax planning and behavioural responses where there are differentials in rates and bands between jurisdictions, or between taxes some of which are devolved and others of which are reserved – which raises the question of whether tax competition is a positive economic tool or encourages tax avoidance.

- The administrative issues and costs that can arise in identifying Scottish taxpayers and building new software to collect income tax from them – which leads to the question of whether there are more efficient ways to administer and collect SIT.

- The tailoring of devolved taxes, which have been ‘cut and pasted’ from the UK legislation to some extent, but with differences to interact with Scots law and to deliver distinct policy aims means that there may be conflicts with the business desire for consistency. Land and Buildings Transaction Tax (LBTT) has elements that are unique to align it with Scots property law (such as with leases), but nevertheless in the three years since its introduction it has become more closely aligned with Stamp Duty Land Tax (SDLT) – which raises questions about the purpose and strategic thinking around devolution or whether there should be greater use of partial devolution (see section 4).
2.4 **Analysis:** Our analysis leads to questions and observations about high level strategic issues, and recommended priorities:

**Across the UK tax system**

- A more logical and consistent strategic framework for the devolution of tax powers across the UK.
- Further consideration of the UK Income Tax framework and how the process of devolution of the rates and bands for NSND income dovetails into it.
- More effective and transparent collaboration between each of the devolved Governments and the UK Government around negotiations on taxation policy.
- Development of better data than is currently available on Scottish taxpayers and the movements between jurisdictions.
- A more realistic time frame between the UK and Scottish Budgets.

**Across the Scottish tax system**

- More openness around strategic thinking.
- Introduction of a Tax Committee in the Scottish Parliament.
- Introduction of an annual care and maintenance provision in the Scottish legislative cycle such as a Finance Act.
- More policy collaboration between Revenue Scotland and the Scottish Government.

2.5 **Sectional questions:** The questions we raise through sections 4 to 14 are meant to provoke discussion with a view to reaching a consensus on what needs to be achieved to optimise the efficiency, practicality, simplicity and transparency of the devolved tax system in Scotland, and more broadly, across the UK, in line with Adam Smith’s four canons of taxation.

2.6 The overarching ‘**Big Question**’ is: Is the current devolution model delivering on its potential?

2.7 **Reasons for preparing this paper:** Individuals need to know and understand what their rights and responsibilities are as citizens of the country. Businesses need to understand what taxation system is prevailing, so they can make informed decisions. Taxation should be transparent, as should the revenue stream and the spending plans of governments.

2.8 A summary and description of Scotland’s tax raising powers and some of the technical terms used can be found in Appendix 1 and Appendix 3 of this paper.

2.9 **Next steps:** The STPF proposes further strategic engagement with government, politicians and wider civic society, with the aim of promoting greater public awareness and understanding of Scotland’s changing tax landscape and its interaction with the wider UK tax regime.
3 Introduction

3.1 In 1997, Scottish people voted by a margin of 74% to 26% in favour of a Scottish Parliament with tax raising powers. A review of the devolution settlement was undertaken in 2008 – 2009 by Professor Sir Kenneth Calman. The Calman Commission, as it became known, was published in June 2009 and paved the way for the devolution of further tax raising powers to the Scottish Parliament contained in the Scotland Act (2012). In the wake of the 2014 referendum on Scottish independence, the Smith Commission, chaired by Lord Smith of Kelvin, recommended the devolution of further tax raising powers. These powers, delivered via the Scotland Act (2016), have led to the current fiscal landscape that we see today.

3.2 Before the Scotland Act 2012 and the Scotland Act 2016 took effect, ‘Scottish taxes’ were limited to Council Tax and Non-domestic Rates, and a power in the Scotland Act 1998 to increase or decrease Income Tax by up to 3% (the Scottish Variable Rate), which was never exercised.

3.3 Scottish taxes have been introduced on a phased basis over the last few years, one of the objectives being that of political philosophy - to increase the financial accountability of the Scottish Parliament and the devolution settlements. Since then, structural fiscal changes\(^2\) have taken place and continue to do so.

3.4 LBTT and Scottish Landfill Tax (SLfT) were introduced in April 2015 to replace SDLT and Landfill Tax. These were followed by implementation of the Scottish Rate of Income Tax (SRIT) in 2016/17 and the more visible implementation in 2017/18 of SIT as a result of Holyrood’s new powers over rates and thresholds for NSND income.

3.5 And that is not all. From 2019 a proportion of the estimated VAT raised in Scotland is to be assigned to the Scottish budget. Air Passenger Duty (APD) in Scotland is to be replaced by a new devolved tax – Air Departure Tax (ADT) – with the legislation in place but a commencement date yet to be agreed due to EU state aid issues. Likewise, Aggregates Levy (AL) is to be devolved at a later date following the resolution of similar issues. There is also the power for the Scottish Parliament to create new taxes so long as this is accepted at Westminster level by an Order in Council.

3.6 By 2020 an estimated £22bn of annual tax revenue will be raised in Scotland, representing around 50% of the devolved Scottish budget (See Appendix 1). This revenue will replace an equivalent proportionate reduction in Block Grant funding.

3.7 There are questions however about the operational impact of the devolved taxes, whether they are as effective as they can be for raising Scottish revenues, and whether there are further considerations about unintended consequences in the rest of the UK tax system that should be taken into account. The current devolved settlement has resulted in Scotland having a partially devolved income tax, which could contribute to unnecessary opaqueness for the Scottish taxpayer.

3.8 Scotland is taking more control over its tax raising and hence its spending: this should bring more accountability. However, devolution is not necessarily a pathway to simplicity – more laws generally lead to complication rather than simplification. So, whilst the Scotland Acts 2012 and 2016 have brought further tax raising powers and devolution to Scotland, in general, taxation has become harder to fathom for all but the seasoned tax practitioner. (For example, the subtle differences in LBTT legislation and SDLT; the additional complication involved in the personal tax computation; the requirement for taxpayers to interact with two tax authorities (HMRC and Revenue Scotland)).

3.9 The House of Lords Select Committee on Economic Affairs raised concerns, when it was scrutinising the most recent Scotland Bill in 2016, that SIT may affect the accountability of the Westminster Parliament to people in Scotland as it may now not be clear to the latter how they fund reserved services and which government is accountable for them.

3.10 With SIT, Scotland has limited autonomy and all the revenue from taxation of NSND income; with VAT, Scotland will have half the revenue from estimated spending in Scotland and no autonomy.

\(^2\) Such as the establishment of Revenue Scotland (Revenue Scotland and Tax Powers Act 2014), the establishment of the Budget Process Review Group (BPRG), and the establishment of the Scottish Fiscal Commission as a statutory body under the Scottish Fiscal Commission Act 2016
4 Scotland’s Tax Landscape

4.1 The phrase ‘Scottish taxes’ is used to cover a variety of allocations of responsibilities and powers, in relation to different taxes, including:

- **‘Full’ devolution**, where total responsibility for the tax is devolved to the Scottish Parliament, such as taxes on land transactions and on disposals of waste to landfill and, in the future, air passengers and aggregates.

- **‘Shared’ or ‘partial’ devolution**, which involves joint responsibilities split between the UK and Scottish Parliaments. This applies to Income Tax, which is currently the only shared tax.

- **‘Assigned’** taxes, where the tax remains a UK tax with full responsibility for legislation and administration sitting with the UK authorities but some of the tax revenue is allocated to Scotland. This is proposed for VAT, where the first 10% of the standard rate and the first 2.5% of the reduced rate are due to be assigned to the Scottish Budget each year. VAT is the only tax allocated in this way, and this is often referred to as an ‘assigned’ tax.

4.2 Revenue Scotland was set up as a result of the Revenue Scotland and Tax Powers Act 2014 (RSTPA 2014) to administer and collect the fully devolved taxes. The Scottish Tax Tribunals are also in place to adjudicate on disputes relating to the fully devolved taxes.

4.3 Note that anything not fully devolved is still ‘reserved’ i.e. the responsibility of the UK Government. Corporation Tax, Capital Gains Tax, and Inheritance Tax are examples of reserved taxes where responsibility remains reserved to Westminster.

4.4 Anecdotal evidence would suggest that there is a lack of understanding amongst taxpayers about these different types of taxes and the ways in which they are devolved. In part, this may be because none of the fully devolved taxes is significant in amount. Nevertheless, being the only taxes fully within the Scottish Parliament’s power, they perhaps have a higher profile than the corresponding taxes in a UK context and can be treated as a broader commentary on Scottish taxes, tax policy, and the Scottish Government’s approach to the wider economy.

4.5 The varied approaches adopted in relation to Scottish taxes also mean that the devolution of taxes to Scotland has already shown itself to be a complicated affair. The negotiations around VAT assignment methodology are a prime example of this and, whilst the methodology has no direct impact on taxpayers, it is a crucial component of the Scottish spending settlement and fiscal framework.

4.6 Given responsibility for Income Tax is shared, using Pay As You Earn (PAYE)\(^3\) to collect SIT is sensible in terms of ease of administration. However, PAYE was designed to ‘pluck the goose with as little hissing’\(^4\) as possible. It is therefore debatable whether this collection mechanism brings knowledge and understanding of SIT to most taxpayers.

4.7 Scotland is subject to a degree of volatility in terms of the taxes from which it receives revenues directly. Income Tax is one of the more stable taxes, subject of course to fluctuations in labour market trends – and yet no substantive figures will become available on the true revenues yielded from SIT until after 2019. The Scottish Fiscal Commission brought some modelling in relation to the volatility of Income Tax receipts into its updated Income Tax forecasts in February and May 2018\(^5\). Undoubtedly, further devolution of other taxes will lend itself to volatility risk, based on the particular Scottish economic, geographic and population related dynamics and the interplay with the Block Grant mechanism.

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\(^3\) HMRC will also administer Welsh income tax using PAYE / Self-Assessment from April 2019

\(^4\) A phrase originally used by Jean Baptiste Colbert – the French economist and Minister of Finance under Louis XIV of France (17\(^{th}\) century)

Questions for discussion

- Is there a general lack of understanding of the devolved tax package?
- Does this package bring accountability to the taxpayer for the actions of the Scottish Parliament; and how does it affect accountability by the UK Parliament?
- Is the devolved taxes package unnecessarily complicated, when considering that businesses and individuals seek simplification, (noting that the concept of local governance and devolution desires, and produces, something different)?
- Or, should the devolved taxes package be more distinct and unique to the devolved jurisdiction?

5 Partially devolved Income Tax

5.1 Partial devolution involves joint responsibilities split between the UK and Scottish Parliaments. This applies to Income Tax and it is the only tax that is partially devolved or shared in this way.

5.2 The UK Parliament is responsible for the ‘tax base’, by which we mean what is considered to be income and how it is measured; administration also sits with HMRC.

5.3 The Scottish Parliament is responsible for setting the rate(s) and bands. Under the Scotland Act 2012 this was a single rate, the SRIT, which was in place in 2016/17 and had to be charged equally across the three bands. However, with effect from April 2017, the Scottish Parliament has had its powers extended so that it is fully responsible for Income Tax rates and bands. In both cases, the SIT rates are applied to NSND6 income of Scottish taxpayers only.

5.4 However, it is debatable if the boundaries of this partially devolved tax are drawn in the right place. Power over rates and bands for Income Tax on investment income has not been devolved but it is open to question whether it should be. If the power to set the rates and bands for the taxation of all income is devolved this would be likely to lead to questions about whether the underlying tax base should be devolved too; and to how income is defined and measured. However, we would caution against this because if the Income Tax base differs significantly between different parts of the UK, this may lend itself to tax avoidance behaviour by creating variants between jurisdictions.

Questions for discussion

- Should the power to set rates and bands for the taxation of investment income be devolved?
- How disruptive for the financial services sector providers would further moves be?
- Is the boundary across the partially devolved Income Tax correctly drawn?

6 The interaction between Scottish Income Tax and UK Income Tax reliefs

6.1 The Scottish Budget for 2018/19 with its five Income Tax rates and bands for Scottish taxpayers gives rise to both operational queries and wider structural questions. These are discussed below.

6.2 Bringing in five Income Tax bands in one part of the tax system makes the interaction with other parts of Income Tax burdensome. In particular, the basic rate is key for withholding tax at source, or for giving relief at source. In Scotland the basic rate now applies to the band of income between £13,850 and £24,000 – with new rates of 19% and 21% introduced above and below this band. This creates an administrative nuisance when giving relief at the correct rate and has affected pensions tax relief and Marriage Allowance in the main, with other anomalies or complications arising on items such as Gift Aid tax relief, mortgage interest tax relief, deficiencies relief, taxation of state pension lump sums and the basic earnings assessment for childcare.

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6 Such as income from employment and self-employment, income from property and pension income
The UK and Scottish Governments have sought practical solutions to address these in relation to 2018/19 but the issues may re-emerge if rates continue to differ in future years. Some of the fundamental problems are not fully resolved in all cases.

6.3 Some allowances are tied to the basic rate as a form of means-testing in the UK, for example, the Marriage Allowance. Compared with the position south of the border, this allowance was already restricted to a limited extent in 2017/18 for Scottish taxpaying couples (to the higher rate threshold of £43,000 rather than £45,000). Following legislative amendments, Scottish taxpayers who pay SIT at the starter, basic and/or intermediate rates are eligible for Marriage Allowance in 2018/19. Nevertheless, due to the higher rate threshold of £43,430 in Scotland, this allowance will continue to be restricted when compared to the UK, where the higher rate threshold is £46,350 for 2018/19.

6.4 HMRC prepared three technical notes\(^7\) in May 2012, December 2014 and November 2016 on the interaction of SIT and the wider Income Tax regime, notably in relation to Gift Aid, pensions and trusts, providing practical guidance on these matters.

6.5 In relation to charitable donations the challenges are somewhat in abeyance for the time being, as the UK Government’s position is that charities should reclaim Gift Aid at the UK basic rate. There is a theoretical risk\(^8\) at the margins as someone paying tax at the starter rate may not have paid enough tax to cover a Gift Aid claim made on their donation at the UK basic rate.

6.6 The practical challenges for pension arrangements operating on a relief at source basis are more of a concern. HMRC has issued further guidance following the 2018/19\(^9\) Scottish rate resolution to address the issues of tax relief, which is practical and helpful. Nevertheless, the introduction of the intermediate band of 21% means that to take advantage of the full tax relief available to them more Scottish taxpayers will need to claim it through PAYE or Self Assessment. It remains to be seen how many do so or whether the corresponding adjustment is correct. There are not many taxpayers who understand the intricacies of an adjustment through a PAYE code.

6.7 In the longer term, with the devolution of Income Tax bands and rates to Scotland, and other devolved jurisdictions, the fundamental concern is whether tax reliefs continue to be given at a standardised rate (say UK basic rate) across the board or should follow the marginal rates in each devolved jurisdiction. Further consideration needs to be given about how to address the issues of providing tax relief at source and whether to give greatest weight to:

- Administrative ease
- Fiscal consequences, or
- Public policy ‘purity’.

### Questions for discussion

- Should the reliefs be devolved?
- Should the UK consider a flat rate of relief – e.g. 20% or 30% for all – unconnected to how much tax is paid – which would mean that higher and additional/top rate taxpayers do not get extra relief?
- Should charities be able to claim an across-the-board flat rate of relief?
- Should reliefs be taken out of Income Tax?
- Are reliefs part of the Income Tax base? Or part of rates and bands?

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7 Increasing scope for tax planning

7.1 Care needs to be taken in adopting a tax competitive policy such as setting low Scottish rates as it may simply lead to further intra-UK competition, ‘a race to the bottom’, and ultimately falling revenues for everyone. Care may also be needed if setting higher rates, as this may lend itself to encouraging tax mitigation strategies.

7.2 More broadly, wherever there are differentials there is scope for tax planning. Whether it is worthwhile to the taxpayer concerned is more difficult to predict but, of course, the wider the differentials the more attractive tax planning may become.

7.3 For those who are Scottish taxpayers, and with a partially devolved tax, consideration needs to be given to NSND income or ‘Scottish income’ (broadly, earnings from employment, self-employment, pensions and rentals) and its interaction with other income (savings and dividends). The impact of any changes in the rates of Income Tax in Scotland also needs to be set in context against UK taxes and trends, such as the ability to change between types of income and between income and gains.

7.4 A business owner may choose to operate as a sole trader (unincorporated and profits liable to Income Tax) or via a company (incorporated and profits liable to Corporation Tax). This taxpayer choice can determine some of the tax outcomes so that the main taxes cannot be considered in isolation, nor in this debate can Income Tax be viewed separately from other policies or matters such as NICs and Capital Gains Tax.

7.5 Any taxpayer who views a tax bill as an unwanted cost will seek to minimise this and so divergent rates across Income Tax (Scottish and UK), Corporation Tax and Capital Gains Tax lend themselves to tax planning behaviours such as incorporation by an individual who wishes to be paid in dividends rather than a salary.

7.6 When some elements are devolved, this opens the way to greater complexity, wider differentials and therefore potential planning if tax costs are increased in one jurisdiction. For instance, if SIT becomes significantly more expensive (and it is not clear where the behavioural tipping point might be), taxpayers may seek to convert sources liable to SIT into something else that is liable to, say, UK Income Tax, Corporation Tax or Capital Gains Tax. Both Corporation Tax and Capital Gains Tax are reserved taxes so any increase in receipts will flow to Westminster, as would be the case with receipts from UK Income Tax, with a corresponding decrease in SIT.

7.7 By way of a simple illustration, if Income Tax rises by 1p and a basic rate taxpayer decides to incorporate and pay himself a salary up to the UK Personal Allowance and the rest in dividends, Scotland loses not only the 1p Income Tax rise value, but also the 20p Income Tax the taxpayer was previously paying into the Scottish purse.

Questions for discussion

- Is it sensible to change elements of the tax system that have so many interactions with other aspects i.e. which are not discrete?
- Is there a way to provide for simpler interaction between SIT and UK Income Tax, NICs, Capital Gains Tax and Corporation Tax?

8 Identification of Scottish, Welsh and other taxpayers

8.1 The Scotland Act 2012 inserted new sections 80D-80F into the Scotland Act 1998, defining who is a Scottish taxpayer for the purposes of Income Tax; this is applicable for both the SRIT (in 2016/17) and SIT for 2017/18 onwards. A Scottish taxpayer is a UK taxpayer who, in very broad terms, has a main place of residence in Scotland.

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10 See Appendix 1
8.2 A concern remains over the number of Scottish taxpayers who have been correctly identified by HMRC (the organisation with responsibility for taxpayer identification). While it is acknowledged that a large percentage of Scottish taxpayers have been identified correctly, there are also some who have not received a Scottish tax code. There are questions over globally mobile and cross-border employees as well as some on modified payroll schemes. There will always be movement between Scotland and the rest of the UK, with around 80,000 people – approximately half in each direction - moving annually.

8.3 If Scotland is to maximise its revenue stream from Income Tax receipts, the number of identified Scottish taxpayers needs to be as accurate as possible (there will always be catch-ups). Otherwise, that revenue will revert to the UK and be lost to Scotland.

8.4 The National Audit Office produced its first full report on the SRIT on 19 December 2016. Amongst its key findings are two important issues: first, that further divergences between the Scottish and the UK rates/bands of Income Tax may create a risk of non-compliance and potential avoidance/evasion. Second, that HMRC’s ability to account for and deliver income to the Scottish Government is potentially undermined by one simple factor – people failing to inform HMRC of their change of address. There is no statutory requirement for taxpayers whose tax is withheld by PAYE to inform HMRC immediately of a change of address.

8.5 HMRC continues to administer Income Tax, effectively working for two jurisdictions, receiving payment from the Scottish Government in return for this service. The National Audit Office’s report of December 2016 reveals that £8.4 million of implementation costs were paid by the Scottish Government in respect of the SRIT in 2015-16. This figure is not intended to be an ongoing annual cost, although there is an annual ‘fee’ paid to HMRC by the Scottish Government out of Income Tax receipts for administering the process.

Question for discussion

- Should the definition of a Scottish taxpayer be changed to make it easier to monitor, bearing in mind that there may be implications for the definition of a Welsh taxpayer or the interaction between the two definitions?

9 Interaction with National Insurance Contributions (NICs)

9.1 The NICs upper earnings limit in 2018/19 has been increased across the UK in line with the rest of the UK (rUK) higher rate threshold for Income Tax, so for those Scottish taxpayers who have an earned income between the two higher rate thresholds of £43,430 (Scottish taxpayers) and £46,350 (rUK taxpayers) there will be a joint marginal rate of 53%, representing 41% Income Tax and 12% NICs (this is currently 50% in total if self-employed).

9.2 There has been considerable work by the Office of Tax Simplification (OTS) in recent years to examine how Income Tax and NIC processes may be aligned in order that these might be streamlined but it was accepted by the OTS there was not a political appetite to merge these two charges.

9.3 Any decision to devolve further tax raising powers, or taxes, rests with the UK Parliament. NICs are, despite many representations, not a tax but a social contribution which entitle the payer to numerous welfare benefits and, under current legislation and ring-fencing arrangements, a future right to a state pension. It is therefore unlikely that NICs will be devolved to Scotland as the National Insurance Fund is tied into the UK state pension and UK welfare regimes. In addition, the legislation upon which NICs are built is extremely complex and the will to unpick it is not currently present.
Question for discussion

- Do Income Tax and NICs need to be viewed as two separate charges on citizens or essentially as one charge on income?

10 Cohesion across the UK – at what level?

10.1 There are questions to consider about which taxes are devolved and whether such devolution should be more logical and coherent across the UK. There may also be questions about whether devolution should be restricted to powers over rate setting, while retaining responsibility for the tax base for each tax at UK level.

10.2 Is it sensible to devolve varying tax powers to different parts of the UK? By way of example, Corporation Tax is being devolved to Northern Ireland, where there has been a commitment to a devolved rate of 12.5% to match that in the Republic of Ireland. However, Corporation Tax has not been devolved to Scotland or Wales.

10.3 If Corporation Tax is to be devolved to Scotland or other parts of Great Britain, or the ability for a limited variation in rates, this could create significant new complexity and administrative burdens, as well as greater opportunities for cross border tax planning and avoidance. It could also encourage a damaging ‘race to the bottom’ which would reduce tax receipts for all administrations in the UK.

10.4 Reservation of Corporation Tax would maintain a level playing field across the UK for reliefs such as Research and Development and patent box as well as avoiding the need for major restructuring to avoid the potential loss of the various reliefs available to corporate groups. It also remains to be seen whether EU or other state aid considerations need to be addressed in considering Corporation Tax devolution.

10.5 There are a number of specialist corporate regimes, for example for financial services or oil and gas, and complications may arise if these were either devolved or it was decided that some types of businesses would remain reserved.

Questions for discussion

- Should there be more consistency in the taxes that are devolved?
- Is Northern Ireland a special case?
- Are there lessons to be learnt from Wales and Northern Ireland?

10.6 Trends so far with devolved taxes have been to align with UK taxes, evident in both directions with, for example, the new LBTT progressive structure being adopted for UK SDLT; then the UK 3% surcharge and first-time buyer relief being introduced into LBTT.

10.7 SLfT has been kept virtually the same as UK Landfill Tax to avoid ‘waste tourism’ – which begs the question, was it a reasonable tax to devolve?

Questions for discussion

- Should the tax base be retained and only rate setting be devolved?
- Are taxes that are primarily designed to inhibit certain behaviours sensible taxes to devolve?
11 Simplification – is it seeking the impossible?

11.1 Income Tax for Scottish taxpayers is more progressive than that for UK taxpayers, but more complex. For those with a range of income sources it may be difficult to understand the combination of bands and how they apply to NSND income, and to savings and dividends income. Accountability is important and is aided by transparency, so this complexity is not helpful.

11.2 Scottish taxpayers’ savings and dividend income are charged at UK rates, taking account of any UK measures such as the Personal Savings Allowance (which will be £500 or £1,000 depending on the amount of total income a taxpayer has using the UK measure) or the dividend zero rate band. This means further complication.

11.3 There are also software costs for payroll administrators, pension providers, and employers. Both HMRC and third-party software providers need to get to grips with the complexity arising from the different Income Tax bands and rates in Scotland and ensure that their products work - and allow taxpayers to file correct returns. Experience with the large number of online filing exceptions HMRC was forced to introduce for 2016/17 returns suggests that HMRC may struggle.

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<td>Is the current structure of partially devolved Income Tax meeting the needs of stakeholders such as taxpayers and the Scottish Government?</td>
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12 Hypothecated taxes

12.1 Questions over the level of taxes and whether public acceptance of further charges may be increased lead to the suggestion that certain taxes would be accepted if raised for specific purposes. By way of example, there is a current debate in England about whether NICs should be increased specifically to fund healthcare. However, healthcare is a devolved competence whilst NICs are reserved. Beyond this, there are both philosophical and operational aspects to consider before going down this route.

12.2 If taxation is levied for the common good, all funds should be collected together and then decisions made about their use. Hypothecation implies that the taxpayer is simply paying for a particular item or service. Following this logic, taxpayers should only pay for what they use and this undermines the notion of contributing to the common good. It also limits flexibility for government policymakers.

12.3 From an operational aspect, restricting funds to the provision of certain goods or services is limiting, adds to the administrative burdens, and reduces flexibility around spending decisions.

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<td>Should taxes be hypothecated and, if so</td>
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<td>Which taxes might lend themselves to being hypothecated in either the UK framework or in the devolved jurisdictions?</td>
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13 Tax processes

13.1 Now that there is devolution, the UK may also need to consider its processes for bringing in new tax policy/legislation. This is because of various areas of overlap between devolved and reserved matters. Something that prima facie appears to relate to reserved tax may affect a devolved policy (whether tax or other). This requires closer working between UK and the devolved administrations.
13.2 By way of example, concerns have been expressed over the way in which the apprenticeship levy was introduced. First, this is a UK wide levy, but apprenticeship training is a devolved matter. Second, the apprenticeship levy appeared to be introduced without the prior knowledge or consultation of the devolved administrations.

13.3 An impact assessment by HM Treasury (HMT) should include an assessment of whether the devolved administrations have been adequately included in the policy making process, with their views given sufficient consideration.

13.4 The UK legislation devolving Income Tax powers is difficult. Measures relevant to SIT are in both the Income Taxes Act 2007 and the Scotland Act 1998 (as amended by the Scotland Acts 2012 and 2016): the legislation is not accessible in a consolidated form, nor is it easy to read, and requires reference to different statutes for completeness. If the devolution of taxes is in part to bring accountability between elected and electorate, it is important that the legislation is accessible to them.

Questions for discussion

• Is new thinking about policy making required in government at Westminster?
• A process is required to make legislative changes in devolved legislation, but what form should it take?

13.5 Both the Land and Buildings Transaction Tax (Scotland) Act 2013 and the Landfill Tax (Scotland) Act 2014 are standalone acts. They are complemented by the RSTPA 2014 which provides the management framework. But, to date, the Scottish budget process has been expenditure focused and so possible amendments to tax law are raised on an ad hoc basis. Since taking effect on 1 April 2015, some anomalies have emerged with the legislation not operating as originally intended particularly in relation to LBTT (such as with group relief provisions). And over the course of three years, there has already been a new charge – Additional Dwelling Supplement (ADS) – and now new reliefs have been introduced or proposed, including one for first-time buyers. With change, the question of process arises – what are the processes for making legislative changes, are they effective and efficient, do they allow for proper scrutiny?

Question for discussion

• Should there be a regular process such as a Scottish Finance Act?

14 The potential for new taxes

14.1 In both Wales and Scotland there is scope for new taxes to be designed and, so far, suggestions put forward include a tourist tax, vacant land tax, and disposable plastics. Wales has indicated that it wishes to examine the potential for new taxes and, no doubt, in the longer term, tax policies which are more distinct from those in the rest of the UK may be needed to meet spending commitments. Scotland could follow the route the Welsh have taken to ask for the powers to introduce new, locally-based taxes to take account of local social responsibility considerations.

Questions for discussion

• What is the rationale for a new tax?
• What taxes are suitable candidates for introducing to the devolved administrations?

11 http://gov.wales/funding/fiscal-reform/welsh-taxes/developing-new-taxes/?lang=en
15 The Scottish Taxes Policy Forum’s recommendations

15.1 The Scottish Taxes Policy Forum has a number of topics it wishes to set down as priorities, which include:

Across the UK tax system

- A more logical and consistent strategic framework for the devolution of tax powers across the UK would be welcomed as it would lend itself to generating a greater understanding and preparedness by taxpayers, businesses and advisers.

- Further consideration of the UK Income Tax framework and how the process of devolution of the rates and bands dovetails into it would enable the UK and Scottish Governments to eliminate unwanted consequences from their chosen plans and actions.

- More effective and transparent collaboration between each of the devolved Governments and the UK Government around negotiations on taxation policy should lead to increased public awareness of devolved taxes. It is important that the public and industry are aware of the devolved taxes space as this leads to increased cooperation and compliance.

- Development of better data than is currently available on Scottish taxpayers and the movements between jurisdictions. At present, for example, Scottish taxpayers are still being discovered by HMRC and there is still an estimation of a gap between who falls into the Scottish taxpayer category and who HMRC has categorised as such, which is detrimental to the Scottish purse.

- A more realistic time frame between the UK and Scottish Budgets to allow more time for the Scottish Government to react. This issue has been considered by the Budget Process Review Group reports, so this paper does not cover it in any further detail.

Across the Scottish tax system

- More openness around strategic thinking – for example, setting out a five-year framework or process map for Scottish taxes, including clear aims and objectives of what the taxes are going to achieve, and to tie in with the Scottish Fiscal Commission’s five-year projections format.

- Introduction of a Tax Committee in the Scottish Parliament, which focuses on taxation in Scotland and sits separately to the Finance and Constitution Committee. This Committee could, for example, comprise members with specialist taxation expertise which would be required to enhance and fortify the tax focus.

- Introduction of an annual care and maintenance provision in the Scottish legislative cycle such as a Finance Act. This would ensure that anomalies and unintended consequences of devolved legislation can be addressed in a regular process without the need for piecemeal amendments by way of either standalone acts or by secondary legislation, while continuing to ensure proper scrutiny.

- More policy collaboration between Revenue Scotland and the Scottish Government. Greater liaison on policy would allow Revenue Scotland to actively input operational experience to policy making, and for policy making to gain from this.

16 Looking forward

16.1 Devolution of tax powers was never going to mean that tax became more straightforward and this is borne out by the mixed bag of devolved, partially devolved and assigned taxes now in place in Scotland. Nor are these likely to remain static – over time, further taxes may be devolved or partially devolved, not forgetting the power in the Scotland Act 1998 for the Scottish Government to levy new taxes. Depending on what happens after Brexit, we may see a form of devolved VAT emerge – but this may take longer than the next five years to consolidate.

The Big Question - Is the current devolution model delivering on its potential?
Scottish Taxes in brief

The following is a brief outline of each of the ‘Scottish taxes’.

Scottish Income Tax (SIT)

- Key legislation is found in:
  - The Scotland Act 1998, as amended by the Scotland Acts 2012 and 2016 – defines who is ‘Scottish’ for Income Tax purposes
  - The Income Taxes Act 2007 – states the rules for tax bands and separates out non-savings, non-dividend (NSND) income.

- A warning however: for those who wish to consider the legislation, this is difficult. Measures relevant to SIT are in both the Income Taxes Act 2007 and the Scotland Act 1998 (as amended by the Scotland Acts 2012 and 2016): the legislation is not accessible in a consolidated form, nor is it easy to read, and requires reference to different statutes for completeness.

- SIT is effective from 1 April 2017; before this an earlier version, the SRIT (a single rate), was in place for one year, 2016/17.

- SIT is charged on NSND income, in other words earnings from employment and self-employment, pension income and rentals.

- Administered by HMRC, mainly through PAYE for those who are employed or pensioners, and through Self-Assessment for the self-employed.

- Estimated liabilities for 2016/17 - £11,267m

SIT is probably the most interesting to observe thus far, due to the number of taxpayers affected and amounts of revenue raised by it. From 2017/18, all Income Tax rates and bands that are chargeable on NSND income are set by the Scottish Parliament. SIT is levied on earnings such as employment income, pensions income, self-employment income and rental income, but not on savings or dividend income.

The SIT rates and bands for 2018/19 are:

<table>
<thead>
<tr>
<th>Income Tax Rates 2018/19</th>
<th>Scottish Thresholds 2018/19</th>
<th>Rest of UK Thresholds 2018/19</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starter Rate 19%</td>
<td>Over £11,850 - £13,850</td>
<td></td>
</tr>
<tr>
<td>Basic rate 20%</td>
<td>Over £13,850 - £24,000</td>
<td>Over £11,850 - £46,350*</td>
</tr>
<tr>
<td>Intermediate rate 21%</td>
<td>Over £24,000 - £43,430</td>
<td></td>
</tr>
<tr>
<td>Higher rate 40%</td>
<td></td>
<td>Over £46,350 - £150,000</td>
</tr>
<tr>
<td>Higher rate 41%</td>
<td>Over £43,430 - £150,000</td>
<td></td>
</tr>
<tr>
<td>Additional Rate 45%</td>
<td></td>
<td>Over £150,000 and above</td>
</tr>
<tr>
<td>Top rate 46%</td>
<td>Over £150,000 and above</td>
<td></td>
</tr>
</tbody>
</table>

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13 SR, BR and I Rates - where an individual is entitled to the standard UK Personal Allowance.

14 As with the rest of the UK, those with earnings exceeding £100,000 will suffer a Personal Allowance reduction of £1 for every £2 earned over £100,000. This gives an effective marginal tax rate for those earning between £100,000 and £123,700 of 60% in the UK. The interaction of Scottish rates and bands and the UK Personal Allowance (currently £11,850) also gives rise to an effective tax rate of 61.5% for those earning between £100,000 and around £123,700.
Who is a Scottish taxpayer?

The Scotland Act 2012 inserted new sections 80D-80F into the Scotland Act 1998, defining who is a Scottish taxpayer for the purposes of Income Tax; this is applicable for both the SRIT (in 2016/17) and SIT for 2017/18 onwards.

A Scottish taxpayer must be UK resident for tax purposes – an individual who is not UK tax resident cannot be a Scottish taxpayer.

There are a number of tests to determine Scottish taxpayer status. If in the course of a tax year an individual is UK resident for tax purposes, they will be a Scottish taxpayer for that tax year, if they satisfy any of three tests:

- They are a Scottish Parliamentarian.
- They have a ‘close connection’ to Scotland through either:
  - having only a single ‘place of residence’, which is in Scotland; or
  - where they have more than one ‘place of residence’, having their ‘main place of residence’ in Scotland for at least as much of the tax year as it has been in any one other part of the UK.
- Where no ‘close connection’ to Scotland or any other part of the UK exists (either through it not being possible to identify any place of residence or a main residence) - through day counting.

Place of residence (something usually established by considering various factors, for example, where daily post is received, where pets are cared for, where doctors and dentists are located and where the individual is registered to vote) is key to establishing whether an individual is a Scottish taxpayer.

Detailed guidance is available at https://www.gov.uk/hmrc-internal-manuals/scottish-taxpayer-technical-guidance/ettg3000.

Land and Buildings Transaction Tax (LBTT)

The Land and Buildings Transaction Tax (Scotland) Act 2013 provides the charge to tax, replacing SDLT in respect of land and buildings in Scotland. It is a tax applied to residential and commercial land and buildings transactions (including commercial purchases and commercial leases) where a chargeable interest is acquired i.e. its locus is in Scotland.

No LBTT is payable on a domestic property worth less than £145,000 or a commercial property worth less than £150,000 because these fall into the nil rate band. However, all transactions over £40,000 are reportable to Revenue Scotland unless they are exempt.

With effect from 1 April 2016, ADS of 3% applies to the purchase of additional dwellings in Scotland (e.g. buy-to-let or second homes) – the legislation has been inserted into Part 3 and schedule 2A to the Land and Buildings Transaction Tax (Scotland) Act 2013; a further amendment, by secondary legislation (The Land

and Buildings Transaction Tax (First-Time Buyer Relief) (Scotland) Order 2018), has introduced a first-buyer-relief with effect from 30 June 2018.

Note that both the tax return and the payment of the LBTT are required before the title to a property is registered by Registers of Scotland.

For further information see the Revenue Scotland website https://www.revenue.scot/.

**Scottish Landfill Tax (SLfT)**

<table>
<thead>
<tr>
<th>Landfill Tax (Scotland) Act 2014</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Scottish Landfill Tax (Administration) Regulations 2015 (SSI 2015/3)</td>
</tr>
<tr>
<td>Effective since 1 April 2015</td>
</tr>
<tr>
<td>Administered by Revenue Scotland and the Scottish Environment Protection Agency (SEPA) 2016/17 – amount collected - £148m&lt;sup&gt;16&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

The Landfill Tax (Scotland) Act 2014 replaced the UK tax charge on disposals to landfill in Scotland from 1 April 2015 with SLfT. The tax is based on the UK Landfill Tax.

The key features of the tax are that it is charged on a taxable disposal, which is a disposal of material as waste by way of landfill and at a landfill site. The tax is levied by weight on the basis of two rates – a standard rate, and a lower rate for certain qualifying materials that are deemed to be less environmentally damaging. There are also a number of activities and materials that are exempt. The tax is designed to raise money, but it also aims to support the rationale of using tax and other charges to support environmental policy, aligned with the Scottish Government’s Zero Waste Plan.

From 1 April 2018 the standard rate of SLfT is £88.95 per tonne and the lower rate is £2.80 per tonne.

Permit or authorisation holders for all Scottish landfill sites, including in-house sites where producers of waste dispose of it themselves, are liable to pay SLfT on taxable disposals.

The tax is self-assessed but in its compliance activities Revenue Scotland is supported by the SEPA.

For further information see the Revenue Scotland website https://www.revenue.scot/.

**Air Departure Tax (ADT)**

<table>
<thead>
<tr>
<th>Air Departure Tax (Scotland) Act 2017</th>
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</thead>
<tbody>
<tr>
<td>Originally expected to be effective from 1 April 2018, but now delayed</td>
</tr>
<tr>
<td>To be administered by Revenue Scotland</td>
</tr>
<tr>
<td>2016/17 – estimated on historical revenues - £282 million&lt;sup&gt;17&lt;/sup&gt;</td>
</tr>
</tbody>
</table>

UK Air Passenger Duty (APD) was expected to be replaced by ADT from 1 April 2018, but it is to be deferred until issues raised by the Scottish Government in relation to the Highlands and Islands exemption have been resolved. The UK Government will maintain the application of APD in Scotland in the interim, and the current APD rates will apply in Scotland for 2018/19 and 2019/20. The Air Departure Tax (Scotland) Act 2017 received Royal Assent in July 2017.

As the name suggests, ADT is based on a charge on any aircraft operator or qualifying private jet that departs any Scottish airport and carries chargeable passengers, with some exemptions.

<sup>16</sup> https://www.revenue.scot/about-us/publications/statistics/scottish-landfill-tax-statistics

<sup>17</sup> http://cdn.obr.uk/DevolvedAutumn2017-1.pdf
The Scottish Parliament is responsible for policy and legislation as well as the rates and bands, although at the time of writing these have not been set.

The manifesto commitment by the Scottish Government is to reduce the tax payable by airlines by 50% by the end of the Parliament; however, no details have yet been issued on this. The Scottish Government has said that at some future point when finances allow it might abolish the tax altogether, although the likelihood is that the rates will simply be changed to nil and the legislation left in place.

The UK Office of Budget Responsibility (OBR) has stated that behavioural outcomes could be a concern if this happened; one consequence of devolving tax powers is that their exercise may lead to tax competition between the devolved jurisdictions and the rest of the UK.

Aggregates Levy (AL)

<table>
<thead>
<tr>
<th>Date of devolution not yet known</th>
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<tbody>
<tr>
<td>2016/17 – estimated on historical revenues - £60 million</td>
</tr>
</tbody>
</table>

The timing of devolution remains uncertain and will not be decided until after a European Commission state aid investigation is complete.

In due course, it is expected that the power to charge tax on the commercial exploitation of aggregate in Scotland will be devolved to the Scottish Parliament. The Scottish Government will be free to make its own arrangements with regard to the design and collection of any replacement tax.

VAT

<table>
<thead>
<tr>
<th>Key legislation is in the Scotland Act 2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective from 2019/20</td>
</tr>
<tr>
<td>Administered by HMRC</td>
</tr>
<tr>
<td>2016/17 - estimated on historical revenues - £5,097m</td>
</tr>
</tbody>
</table>

Some VAT is due to be assigned to Scotland from 2019/20. The Smith Commission recommended that:

The receipts raised in Scotland by the first 10 percentage points of the standard rate of Value Added Tax (VAT) will be assigned to the Scottish Government’s budget.

These receipts should be calculated on a verified basis, to be agreed between the UK and Scottish Governments, with a corresponding adjustment to the block grant received from the UK Government.

The Scotland Act 2016 also provided for the first 2.5p of the reduced rate of VAT to be assigned. At the time of writing, the basis of assignment has yet to be agreed.

18 http://cdn.obr.uk/DevolvedAutumn2017-1.pdf
Adam Smith’s four canons of taxation

The Scottish Government’s approach to taxation in general is founded on four principles – certainty, convenience, efficiency and proportionality to the ability to pay. These are discussed briefly below. While individual taxes may not be able to meet each principle, it may be possible for the overall system to meet the principles – the difficulty for Scotland being that it only has powers over a limited number of taxes.

The burden should be proportionate to the ability to pay
The principle of ‘ability to pay’ is generally viewed as a proportionate rise in tax rates as income increases, although this can be less clear cut in transaction-based taxes such as LBTT or APD. Further, in relation to LBTT, the operation of this principle can be undermined by behavioural outcomes such as fewer purchases of property; the principle itself may undermine other objectives such as stimulating the economy, if housing mobility becomes restricted due to tax costs.

Depending on which tax is being considered, there may also need to be further articulation of ‘proportionality to the ability to pay’. The term ‘ability to pay’ is subjective and should be refined, for example, in relation to local Council Tax and whether it is to reflect gross income only, disposable income or income less essential expenditure; or the term ‘ability to pay’ may be wider and judged against a combination of income and capital. LBTT is better aligned to ‘ability to pay’ than the earlier SDLT, due to the move away from a slab tax approach. Ability to afford a more expensive property may give a strong indication of a greater ability to pay tax but, for those with a mortgage, increasing tax usually means reduced funds available to purchase the property.

Provide certainty to the taxpayer
One of the four principles is ‘certainty’, which in our view includes both simplicity and stability. This involves certainty about the amount of tax that is due, when it is due and also about how tax is worked out. To provide certainty it would be helpful if a relatively long-term view could be taken with a minimum number of changes to the thresholds and rates and tax base over time. This will enable taxpayers, both individuals and businesses, to plan ahead with confidence. Certainty is also important to encourage economic investment; business will not invest if the tax treatment is uncertain. Examples of where there is relative certainty have traditionally been found with Council Tax and Business Rates. Examples of where there is less certainty can be found with the unexpected introduction of ADS, or in Income Tax where there might be uncertainty over future rates and bands, or Scottish taxpayer status in some instances.

Provide convenience/ease of payment
Under this principle, tax should be raised in a manner and at a time that is of maximum convenience to the taxpayer. With that in mind, the processes for submitting returns and making payments for the fully devolved taxes, LBTT and SLfT have been developed to be digital first. We consider that the payment and administrative processes for LBTT provide convenience, particularly in comparison with previous SDLT systems. This is particularly the case with the link that exists between payment of LBTT and the provision of land registration documentation. In addition, for the shared tax, SIT, administration and collection continue to be carried out by HMRC using PAYE and Self-Assessment. PAYE in particular is convenient for individual taxpayers, as Income Tax is automatically deducted at source from their pay.

Be efficient
The canon of efficiency (or economy) advises that the cost of collection of a tax should be minimised – with the effect of maximising revenue from the tax. It is essential that the administration of taxes does not consume the revenue that they raise. The Scottish Government has committed to comparing itself to international standards to ensure that administration of tax uses up as little tax revenue as possible. As part of this, the Scottish Government established Revenue Scotland as an independent, non-ministerial department to administer the fully devolved taxes, LBTT and SLT. To maximise efficiency, Revenue Scotland works closely with Registers of Scotland in respect of LBTT and with the SEPA in respect of SLT. In contrast, Income Tax for the majority of taxpayers is collected by HMRC by way of PAYE, a system designed to collect tax efficiently, and this remains the case for SIT. Given the nature of SIT as a shared tax, this is currently the most efficient approach to its administration.

Other principles
The Scottish Government has set out its overarching principles, but it may also be helpful to distinguish between very high-level principles and objectives. In broad terms, it needs to be decided what the objectives of tax raising are and the balance between them. So, for example, the key objectives are likely to be to raise funds, bring accountability, support other policies such as economic growth, and redistribute resources. It also needs to be recognised that the objectives and the achievement of the four principles may differ with each different tax. Furthermore, the principles may need to be balanced with each other as they sometimes conflict.
## Glossary of terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Meaning</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adam Smith’s four canons of taxation</td>
<td>The four canons of taxation were set out by Adam Smith in his book <em>An Inquiry into the Nature and Causes of the Wealth of Nations</em> (1776). These are principles or maxims that Adam Smith thought should be followed when designing a tax system. (See Appendix 2)</td>
</tr>
<tr>
<td>Additional Dwelling Supplement (ADS)</td>
<td>ADS applies to the purchase of additional dwellings in Scotland (e.g. buy-to-let or second homes). It results in the charge of an additional amount of LBTT at a rate of 3%. It took effect from 1 April 2016,</td>
</tr>
<tr>
<td>Aggregates Levy (AL)</td>
<td>AL is a tax on sand, gravel and rock that has either been dug from the ground, dredged from the sea in UK waters or imported. The Scotland Act 2016 makes provision for AL to be devolved to the Scottish Parliament. This will happen once outstanding EU state aid and legal issues have been resolved.</td>
</tr>
<tr>
<td>Air Departure Tax (ADT)</td>
<td>ADT is expected to replace UK APD in Scotland. It will be a tax charged on the carriage of chargeable passengers on chargeable aircraft by air from airports in Scotland. Revenue Scotland will administer and collect ADT. The introduction of ADT will be deferred until issues in relation to the exemption for flights departing from the Highlands and Islands have been resolved.</td>
</tr>
<tr>
<td>Air Passenger Duty (APD)</td>
<td>APD is an excise duty charged on the carriage of chargeable passengers from a UK or Isle of Man airport on a chargeable aircraft.</td>
</tr>
<tr>
<td>Behavioural responses</td>
<td>It is generally acknowledged that taxpayers respond to changes in tax policy. Such responses are uncertain and difficult to quantify. There are three main kinds of response: to changes in their marginal tax rate; to changes in their average rate of tax; and forestalling to minimise a tax liability – generally a one-off opportunity.</td>
</tr>
<tr>
<td>Block Grant</td>
<td>This is the element of the devolved administrations’ funding that comes directly from the UK Government (HM Treasury). Once the block grant has been determined, the devolved administrations (e.g. Scotland) have freedom to make their own spending decisions in areas of devolved responsibilities. The block grant is adjusted to reflect the devolved administrations’ devolved revenue raising powers.</td>
</tr>
<tr>
<td>Gift Aid</td>
<td>Gift Aid is a means of making donations to charities or Community Amateur Sports Clubs (CASCs). If you donate using Gift Aid, the charity or CASC can claim back from HMRC the basic rate tax that you have paid on the amount of the donation. So, if you donate 80p under Gift Aid, the charity can claim an extra 20p. If you pay tax at a rate above the basic rate (20%), you can claim extra tax relief of the difference between the rate you pay and the basic rate on your donation.</td>
</tr>
<tr>
<td>Term</td>
<td>Meaning</td>
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<tr>
<td>HM Revenue &amp; Customs (HMRC)</td>
<td>HMRC is the UK tax authority responsible for the administration of UK taxes and customs duties. HMRC also has responsibility for the payment of Tax Credits and Child Benefit. HMRC was established in 2005 as a non-ministerial department, replacing the Inland Revenue and Customs &amp; Excise. (<a href="https://www.gov.uk/government/organisations/hm-revenue-customs/about">https://www.gov.uk/government/organisations/hm-revenue-customs/about</a>).</td>
</tr>
<tr>
<td>Hypothecation</td>
<td>The hypothecation of a tax can also be known as the ring-fencing or earmarking of a tax. It is the dedication of the revenue from a specific tax for a particular expenditure purpose or public policy goal. The classical method of taxation differs in that all government spending comes from a consolidated fund of all tax revenues.</td>
</tr>
<tr>
<td>Incorporation</td>
<td>Incorporation is the process by which a new or existing business registers as a limited company; UK limited companies are incorporated at Companies House under the Companies Act 2006. A company is a legal entity with a separate legal identity from those who own or run it. Most companies are limited liability companies – the liability of their members is limited either by shares or guarantee.</td>
</tr>
<tr>
<td>Land and Buildings Transaction Tax (LBTT)</td>
<td>LBTT replaced UK SDLT in Scotland from 1 April 2015. LBTT is a tax applied to residential and commercial land and buildings transactions (including commercial purchases and commercial leases) where a chargeable interest in Scotland is acquired. Revenue Scotland administers LBTT with support from Registers of Scotland.</td>
</tr>
<tr>
<td>Marriage Allowance</td>
<td>Marriage Allowance is also known as the transferable tax allowance for married couples and civil partners. It is not an extra allowance – it is part of the Personal Allowance. If both spouses / civil partners meet certain conditions, one can transfer some of their Personal Allowance to the other. The recipient of the Marriage Allowance does not receive extra Personal Allowance; instead they receive a non-repayable tax credit worth 20% of the Marriage Allowance.</td>
</tr>
<tr>
<td>Non-savings, non-dividend (NSND) income</td>
<td>SIT applies to NSND income of Scottish taxpayers. This is employment income, profits from self-employment, rental profits, pension income and taxable benefits. UK tax legislation defines savings income and dividend income but does not define other types of income, resulting in this ‘negative’ description of the types of income subject to SIT.</td>
</tr>
<tr>
<td>Office of Tax Simplification (OTS)</td>
<td>The OTS is an independent office of HM Treasury. It gives independent advice to the UK Government on simplifying the UK tax system. Its objective is to reduce tax compliance burdens on taxpayers and promote greater understanding of the UK tax system.</td>
</tr>
<tr>
<td>Term</td>
<td>Meaning</td>
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<tr>
<td>Pay As You Earn (PAYE)</td>
<td>HMRC asks employers and pension providers to deduct tax from pay and pensions under the PAYE system. HMRC uses a system of codes to tell employers how much tax to deduct, with the aim of collecting the correct amount of tax from each payment and spreading tax allowances evenly throughout the year.</td>
</tr>
<tr>
<td>Revenue Scotland</td>
<td>Revenue Scotland is the Scottish tax authority responsible for the management and collection of Scotland’s devolved taxes. It was established as a non-ministerial department on 1 January 2015. (<a href="https://www.revenue.scot/about-us">https://www.revenue.scot/about-us</a>) and is governed by the Revenue Scotland and Tax Powers Act 2014.</td>
</tr>
<tr>
<td>Scottish Fiscal Commission (SFC)</td>
<td>The SFC is a non-ministerial office, which is structurally and operationally independent of the Scottish Government. It produces independent forecasts of Scotland’s revenue from fully devolved taxes and SIT, devolved demand-led social security expenditure and onshore Gross Domestic Product (GDP). The SFC was a non-statutory body from June 2014 to March 2017 but was made a statutory body by virtue of the Scottish Fiscal Commission Act 2016.</td>
</tr>
<tr>
<td>Scottish Income Tax (SIT)</td>
<td>SIT is not fully devolved to the Scottish Parliament. Limited powers are devolved to the Scottish Parliament – to set the rates and bands of Income Tax that apply to the NSND income of Scottish taxpayers. It took effect on 6 April 2017. HMRC administers SIT. Crucially, the Personal Allowance and definition of the tax base remain reserved to the UK.</td>
</tr>
<tr>
<td>Scottish Landfill Tax (SLIT)</td>
<td>SLIT replaced UK Landfill Tax in Scotland from 1 April 2015. SLIT is a tax on the disposal of waste to landfill and is charged by weight on the basis of two rates: a standard rate for active materials; and a lower rate for less polluting (referred to as ‘inert’) materials. Operators of landfill sites in Scotland are liable for SLIT. Revenue Scotland administers SLIT with support from the SEPA.</td>
</tr>
<tr>
<td>Scottish Rate of Income Tax (SRIT)</td>
<td>The SRIT was a limited power that the Scottish Parliament had, to set one rate of Income Tax for the tax year 2016/17. Each of the basic, higher and additional rates as set by the UK Parliament were reduced by 10% and the SRIT (which was set at 10%) added to each one. This determined the tax rates payable by Scottish taxpayers on their NSND income in 2016/17.</td>
</tr>
<tr>
<td>Scottish Taxes</td>
<td>In this paper we include the following within the ambit of ‘Scottish taxes’: fully devolved taxes (LBTT, SLIT, and in future ADT and AL), shared taxes (SRIT and SIT) and assigned taxes (VAT).</td>
</tr>
<tr>
<td>Term</td>
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<tr>
<td>Scottish Taxpayer</td>
<td>The definition and tests for determining who is a Scottish taxpayer for the purposes of SIT are set out in legislation. The definition is based around where an individual lives in the course of a tax year. Only individuals can be Scottish taxpayers for the purposes of SIT. Trusts, deceased estates, a body of trustees and personal representatives cannot be Scottish taxpayers and cannot be chargeable to SIT.</td>
</tr>
<tr>
<td>Self-Assessment</td>
<td>Self-Assessment is a way of paying tax, in particular Income Tax for individuals. The taxpayer is responsible for completing a tax return each tax year if they need to and for paying any tax due. It is also the taxpayer’s responsibility to notify HMRC if they think that they need to complete a tax return.</td>
</tr>
<tr>
<td>Stamp Duty Land Tax (SDLT)</td>
<td>SDLT is a tax applied to residential and commercial land and buildings transactions where a chargeable interest in England or Northern Ireland is acquired. HMRC administers the tax. A Welsh devolved equivalent was also established in 2018 – Land Transaction Tax.</td>
</tr>
<tr>
<td>Tax avoidance</td>
<td>HMRC defines tax avoidance as bending the rules of the tax system to gain a tax advantage that was not intended by Parliament. Tax avoidance may involve the use of contrived, artificial transactions. It can also be viewed as operating within the letter, but not the spirit, of the law.</td>
</tr>
<tr>
<td>Tax base</td>
<td>The tax base is the aggregate value of the financial streams or assets on which tax can be imposed. In the case of Income Tax, for instance, the tax base is determined by the definition of what can be taxed (taxable income) and the setting of the Personal Allowance.</td>
</tr>
<tr>
<td>Tax competition</td>
<td>Tax competition is the process by which different tax jurisdictions use tax to attract investment and wealthy individuals. This generally involves minimising the overall tax burden and/or the creation of special tax preferences.</td>
</tr>
<tr>
<td>Tax planning</td>
<td>Tax planning is generally described as the legal process of arranging tax affairs so as to minimise tax liability, through the legitimate use of reliefs and exemptions.</td>
</tr>
<tr>
<td>VAT assignment</td>
<td>The Scotland Act 2016 provides for the assignment of the first 10p of the standard rate of VAT and the first 2.5p of the reduced rate of VAT to the Scottish Government. Under the fiscal framework, VAT assignment will be implemented in 2019/20, but this will be a transitional year. VAT assignment will only start to affect the Scottish Government’s budget from 2020/21.</td>
</tr>
<tr>
<td>Withholding at source</td>
<td>Withholding at source normally occurs in relation to a tax on income. It means that the payer of the income pays the tax to the tax authority, rather than the recipient of the income. The recipient receives the net amount of income, after the tax has been deducted by the payer. The tax withheld is treated as a payment on account of the recipient’s final tax liability. In the UK, an example is the PAYE system.</td>
</tr>
</tbody>
</table>
List of Questions in this paper

The overarching ‘Big Question’ is: Is the current devolution model delivering on its potential?

From section 4

- Is there a general lack of understanding of the devolved tax package?
- Does this package bring accountability to the taxpayer for the actions of the Scottish Parliament; and how does it affect accountability by the UK Parliament?
- Is the devolved taxes package unnecessarily complicated, when considering that businesses and individuals seek simplification, (noting that the concept of local governance and devolution desires, and produces, something different)?
- Or, should the devolved taxes package be more distinct and unique to the devolved jurisdiction?

From section 5

- Should the power to set rates and bands for the taxation of investment income be devolved?
- How disruptive for the financial services sector providers would further moves be?
- Is the boundary across the partially devolved Income Tax correctly drawn?

From section 6

- Should the reliefs be devolved?
- Should the UK consider a flat rate of relief — e.g. 20% or 30% for all — unconnected to how much tax is paid — which would mean that higher and additional/top rate taxpayers do not get extra relief?
- Should charities be able to claim an across-the-board flat rate of relief?
- Should reliefs be taken out of Income Tax?
- Are reliefs part of the Income Tax base? Or part of rates and bands?

From section 7

- Is it sensible to change elements of the tax system that have so many interactions with other aspects i.e. which are not discrete?
- Is there a way to provide for simpler interaction between SIT and UK Income Tax, NICs, Capital Gains Tax and Corporation Tax?

From section 8

- Should the definition of a Scottish taxpayer be changed to make it easier to monitor, bearing in mind that there may be implications for the definition of a Welsh taxpayer or the interaction between the two definitions?

From section 9

- Do Income Tax and NICs need to be viewed as two separate charges on citizens or essentially as one charge on income?

From section 10

- Should there be more consistency in the taxes that are devolved?
- Is Northern Ireland a special case?
- Are there lessons to be learnt from Wales and Northern Ireland?
- Should the tax base be retained, and only rate setting be devolved?
- Are taxes that are primarily designed to inhibit certain behaviours sensible taxes to devolve?

From section 11

- Is the current structure of partially devolved Income Tax meeting the needs of stakeholders such as taxpayers and the Scottish Government?
From section 12

- Should taxes be hypothecated and, if so
- Which taxes might lend themselves to being hypothecated in either the UK framework or in the devolved jurisdictions?

From section 13

- Is new thinking about policy making required in government at Westminster?
- A process is required to make legislative changes in devolved legislation, but what form should it take?
- Should there be a regular process such as a Scottish Finance Act?

From section 14

- What is the rationale for a new tax?
- What taxes are suitable candidates for introducing to the devolved administrations?
Quick read: executive summary and STPF recommendations
(Extracted from sections 2 and 15 of main document)

1 **Purpose**: This paper aims to review and provide a critique of the current tax powers that have been devolved to the Scottish Parliament - their challenges, risks and opportunities - and to discuss the progress of devolution of taxes to Scotland since the 1998 Scotland Act. The aim is to initiate a debate amongst tax practitioners, academics and government with the eventual objective of this debate filtering through to the general public, to promote awareness and wider discussion. The main focus is on the taxes devolved in the Scotland Acts of 2012 and 2016 with a special emphasis on Scottish Income Tax (SIT), given its importance in terms of numbers of taxpayers affected and revenues raised.

2 **Underlying principle**: Adam Smith's four canons of taxation have been adopted by the Scottish Government in its approach to taxation, namely, certainty, convenience, efficiency and burden proportionate to the ability to pay. These are high level principles, but there are also other objectives such as the need to raise funds, bring accountability, support other policies such as economic growth, and redistribute resources.

3 **Focus**: This paper focuses on the operational aspects of Scottish taxes with the questions of principle that such operational matters flush out, such as:
   - The interaction of SIT rates with UK mechanisms for giving tax relief at source (e.g. pensions relief, or Gift Aid) - which leads to the question of whether Income Tax reliefs should be delivered in a different way, devolved, or abolished altogether.
   - The need for both SIT calculations for non-savings, non-dividend (NSND) income and UK based calculations if a Scottish taxpayer also has savings income and dividends introduces added complexity for taxpayers, agents and HM Revenue & Customs (HMRC) – which leads to the question of whether Income Tax rates and bands applicable to all sources of income should be devolved.
   - The possibility of tax planning and behavioural responses where there are differentials in rates and bands between jurisdictions, or between taxes some of which are devolved and others of which are reserved – which raises the question of whether tax competition is a positive economic tool or encourages tax avoidance.
   - The administrative issues and costs that can arise in identifying Scottish taxpayers and building new software to collect Income Tax from them – which leads to the question of whether there are more efficient ways to administer and collect SIT.
   - The tailoring of devolved taxes, which have been ‘cut and pasted’ from the UK legislation to some extent, but with differences to interact with Scots law and to deliver distinct policy aims means that there may be conflicts with the business desire for consistency. Land and Buildings Transaction Tax (LBTT) has elements that are unique to align it with Scots property law (such as with leases), but nevertheless in the three years since its introduction it has become more closely aligned with Stamp Duty Land Tax (SDLT) – which raises questions about the purpose and strategic thinking around devolution or whether there should be greater use of partial devolution.

4 **Analysis**: Our analysis leads to questions and observations around high level strategic issues, and recommended priorities:

**Across the UK tax system**
   - A more logical and consistent strategic framework for the devolution of tax powers across the UK would be welcomed as it would lend itself to generating a greater understanding and preparedness by taxpayers, businesses and advisers.
   - Further consideration of the UK Income Tax framework and how the process of devolution of the rates and bands dovetails into it would enable the UK and Scottish Governments to eliminate unwanted consequences from their chosen plans and actions.
• More effective and transparent collaboration between each of the devolved Governments and the UK Government around negotiations on taxation policy should lead to increased public awareness of devolved taxes. It is important that the public and industry are aware of the devolved taxes space as this leads to increased cooperation and compliance.

• Development of better data than is currently available on Scottish taxpayers and the movements between jurisdictions. At present, for example, Scottish taxpayers are still being discovered by HMRC and there is still an estimation of a gap between who falls into the Scottish taxpayer category and who HMRC has categorised as such, which is detrimental to the Scottish purse.

• A more realistic time frame between the UK and Scottish Budgets to allow more time for the Scottish Government to react. This issue has been considered by the Budget Process Review Group reports, so this paper does not cover it in any further detail.

Across the Scottish tax system

• More openness around strategic thinking – for example, setting out a five-year framework or process map for Scottish taxes, including clear aims and objectives of what the taxes are going to achieve, and to tie in with the Scottish Fiscal Commission’s five-year projections format.

• Introduction of a Tax Committee in the Scottish Parliament, which focuses on taxation in Scotland and sits separately to the Finance and Constitution Committee. This Committee could, for example, comprise members with specialist taxation expertise which would be required to enhance and fortify the tax focus.

• Introduction of an annual care and maintenance provision in the Scottish legislative cycle such as a Finance Act. This would ensure that anomalies and unintended consequences of devolved legislation can be addressed in a regular process without the need for piecemeal amendments by way of either standalone acts or by secondary legislation, while continuing to ensure proper scrutiny.

• More policy collaboration between Revenue Scotland and the Scottish Government. Greater liaison on policy would allow Revenue Scotland to actively input operational experience to policy making, and for policy making to gain from this.

Sectional questions: The questions we raise through sections 4 to 14 are meant to provoke discussion with a view to reaching a consensus on what needs to be achieved to optimise the efficiency, practicality, simplicity and transparency of the devolved tax system in Scotland, in line with Adam Smith’s four canons of taxation.

The overarching ‘Big Question’ is: Is the current devolution model delivering on its potential?

Reasons for preparing this paper: Individuals need to know and understand what their rights and responsibilities are as citizens of the country. Businesses need to understand what taxation system is prevailing, so they can make informed decisions. Taxation should be transparent, as should the revenue stream and the spending plans of governments.

Next steps: The STPF proposes further strategic engagement with government, politicians and wider civic society, with the aim of promoting greater public awareness and understanding of Scotland’s changing tax landscape and its interaction with the wider UK tax regime.
The Scottish Taxes Policy Forum

The Scottish Taxes Policy Forum (STPF) was formed in 2017 by the Institute of Chartered Accountants of Scotland (ICAS) and the Chartered Institute of Taxation (CIOT) to collaborate on technical analysis of Scottish tax matters. The group aims to produce and build alignment around expert opinions that are clear, realistic, accurate and politically neutral.

For this paper the STPF is grateful for the contributions of a number of interested parties, all of whom have an interest in promoting greater awareness and understanding of the tax regime applicable in Scotland.

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Chris Young

The views expressed are those of the STPF and should not be attributed to any individual or single organisation.

The Institute of Chartered Accountants of Scotland (ICAS) is the world’s oldest professional body of accountants and we represent over 21,000 members working across the UK and internationally. Our members work in all fields, predominantly across the private and not for profit sectors.

ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and financial system design, and to point out operational practicalities.

www.icas.com

The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

www.tax.org.uk